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THE 1996 FAIR ACT: EFFECTS, PITFALLS, AND OPPORTUNITIES

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After lengthy debate, a significant change in U.S. policy occurred on April 4, 1996 when the Federal Agriculture Improvement and Reform (FAIR) Act became law. The act is a watershed bill because it represents a major change in policy direction for commodity programs (supply management and price support/stabilization), the environment, and rural communities. Commonly called the 1996 Farm Bill, the FAIR Act decouples direct income support payments from farm prices for seven years.

Previously, income support came in the form of deficiency payments, calculated as the difference between a target price and farm-level price, that varied significantly from year to year. FAIR, however, provides for seven years of annual fixed but declining flexibility contract payments that are not influenced by current crop plantings, production, or market prices.

Omnibus farm bills deal with many policy aspects other than commodity program provisions. A subset of some of the major changes or new provisions are listed below. Following the overview of provision changes, a brief description of what these changes mean for general policy direction, market behavior, agricultural producers, and agribusiness is provided. The paper closes with conclusions on new pitfalls and opportunities that will likely result from these watershed changes.

Major Provisions of the FAIR Act

Price and Income Support

- Replaces deficiency payments with flexibility contract payments
- Suspends 1938 and 1949 Price Support Authority

Supply Management and Price Stabilization

- Eliminates annual set asides
- Allows CRP early outs and new enrollment
- Revises marketing assistance loan structure, Loan Deficiency Payments, (LDPs)
- Suspends Farmer Owned Reserve
- Caps Export Enhancement Program expenditures below GATT levels

Environment and Rural Community

- Combines environment/conservation programs; better coordination
- Establishes Environmental Quality Incentives Program (EQIP); cost share with 50% for livestock
- Establishes Fund for Rural America; rural infrastructure, research and development

Other Provisions

Establishes Office for Risk Management; research and education on risk management
Establishes Commission on 21st Century Production Agriculture; future recommendations

What FAIR Means

For Policy Direction

Reduced production control and supply management
Increased coordination of environmental programs
Revamped safety net structure; price and income support, disaster assistance

For Markets

Increased price variability
Greater interaction with international markets

For Producers

Market driven production decisions with planting flexibility
Increased importance of marketing, and financial and risk management; timing of crop sales more difficult and important; marketing and risk management tools will require more care; requires an integrated production and financial management approach
Livestock producers will face volatile, although probably lower on average, feed costs in the future
Will reward efficient marketing and management, punish inefficiency

For Agribusiness

Strong crop production and consistent input sales (no government set asides)
More rapid shifts in crops planted; increased market orientation and rotations
Increased producer financial volatility and defaults from "risky" marketing tools

Figures 1, 2, and 3 present how this year's corn market situation significantly changed from April to August. The unusual price variability exhibited in 1996 can be attributed to reduced government intervention and to the low level of carryover stocks.

Figure 4 illustrates the reduced level of carryover stocks for corn, as compared historically, and shows inter-year price movements. In Figure 5, intra-year price movement and volatility is demonstrated by the divergence in July and December futures contract settlement prices for corn.

Figure 6 shows the stability in expected government payments for Iowa. Projections for Iowa Farm Cash Receipts are presented in Figure 7. It is noteworthy that in 1996, for the first time in history, both crops and livestock cash receipts will top \$6 billion at the same time. Receipts are expected to be strong throughout the projection period.

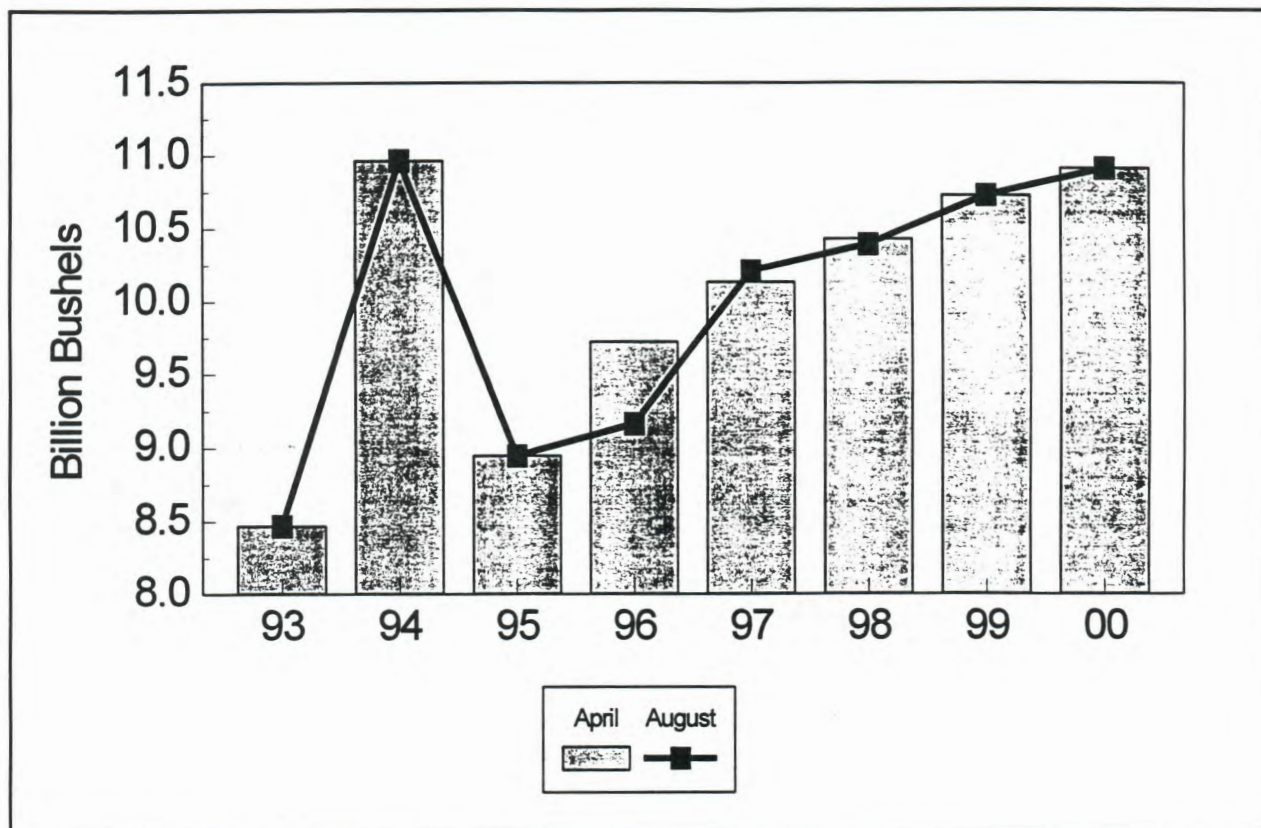


Figure 1. U. S. corn supply

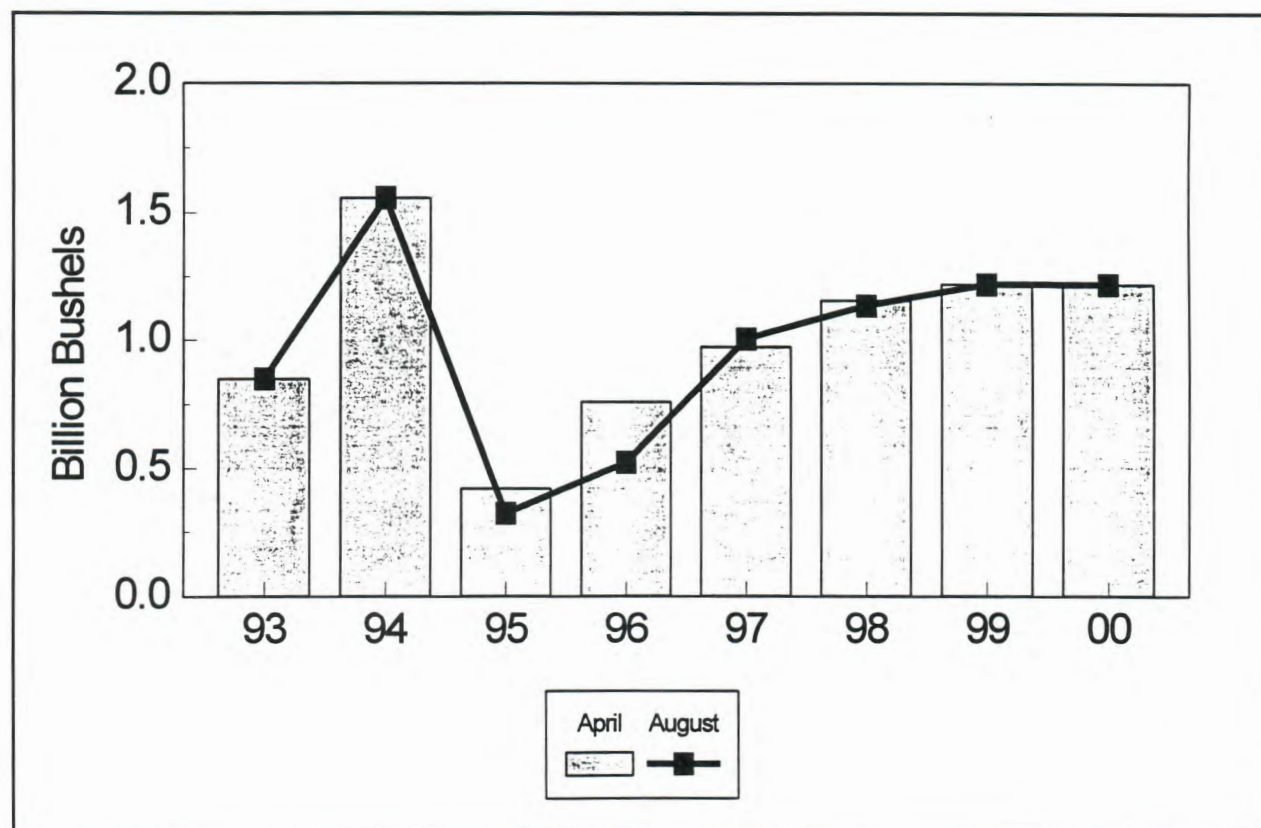


Figure 2. U. S. corn ending stocks

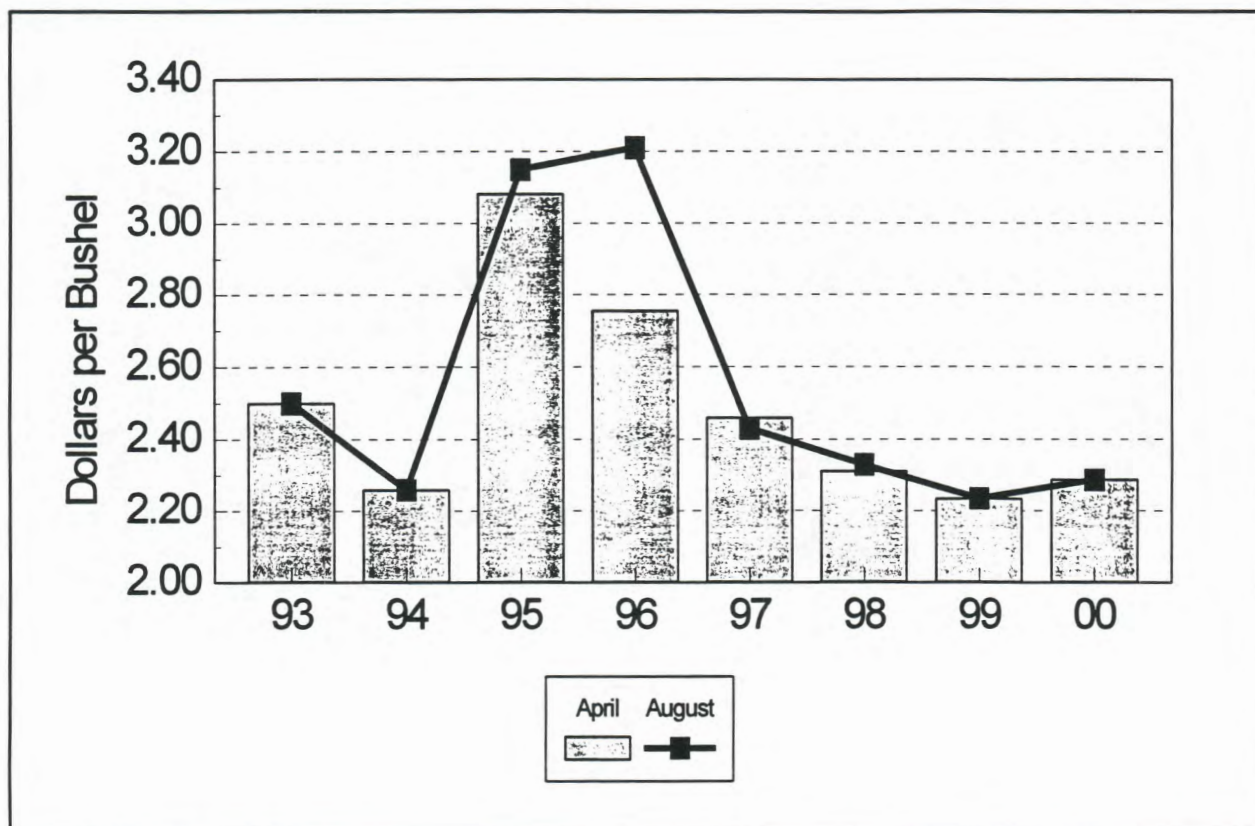


Figure 3. U. S. corn prices

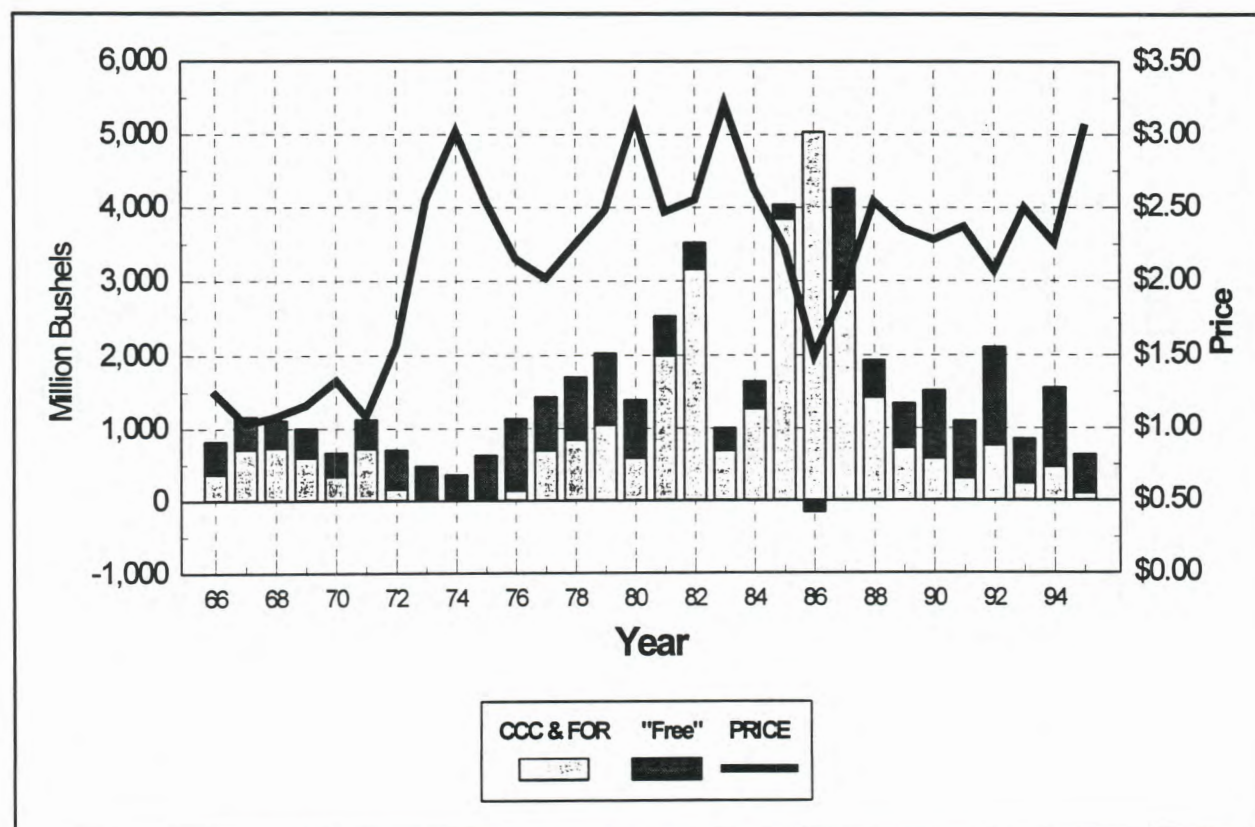


Figure 4. Ending stocks and corn prices

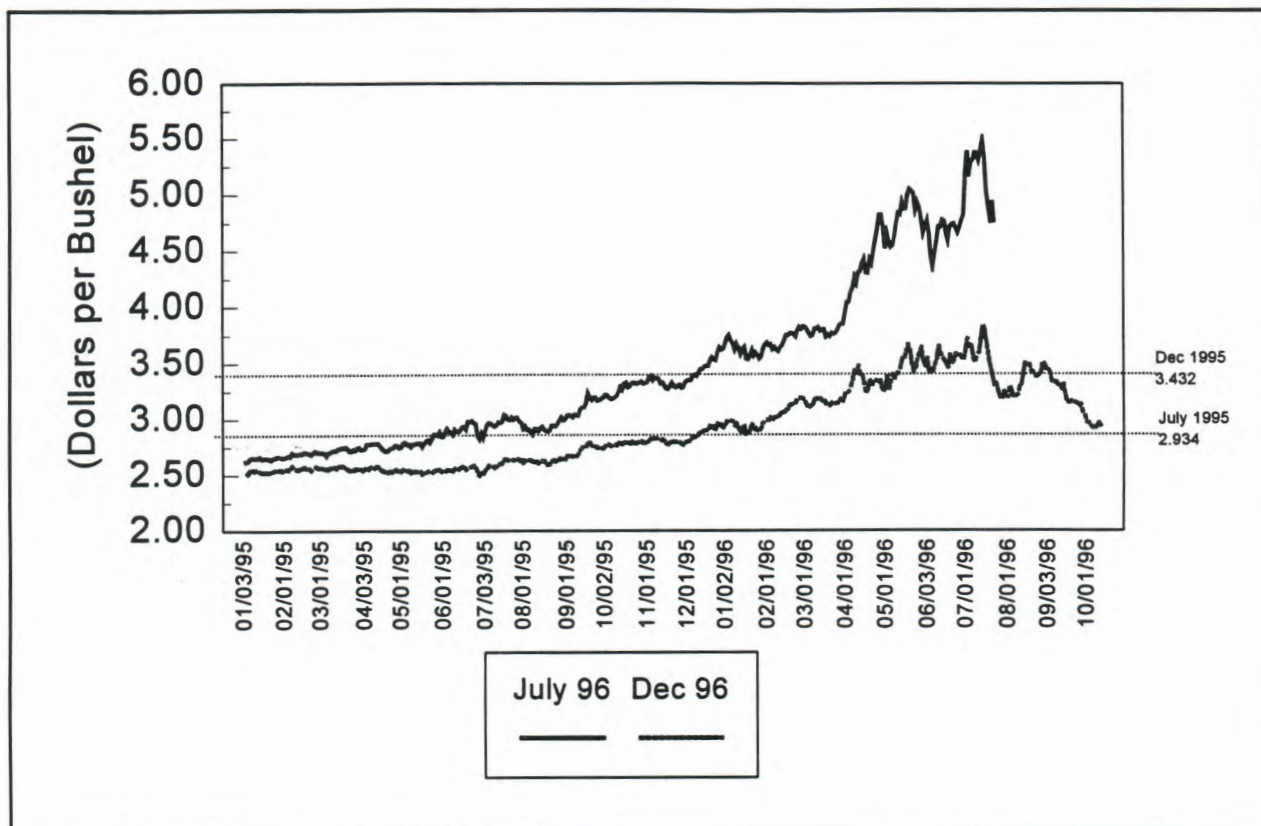


Figure 5. Corn futures settlement price

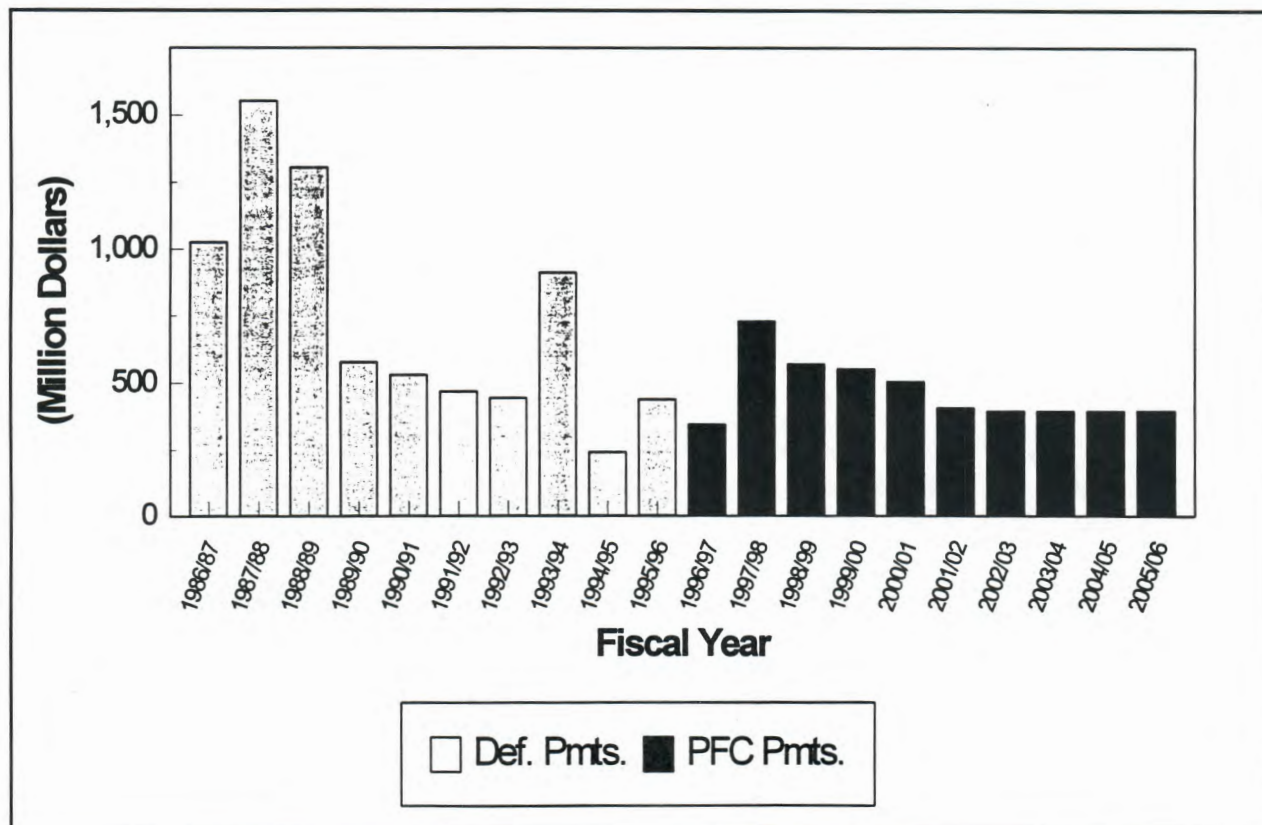


Figure 6. Expected government payments for Iowa

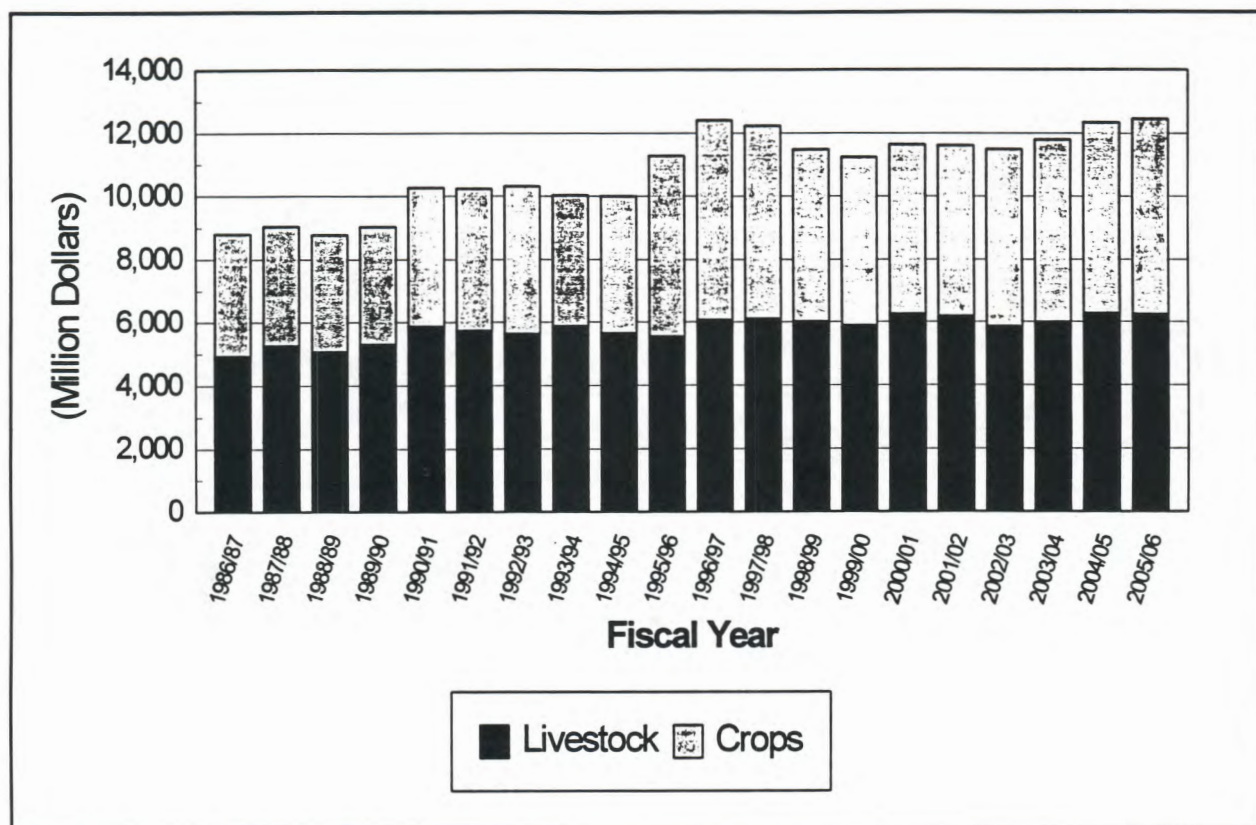


Figure 7. Iowa farm cash receipts

Pitfalls and Opportunities

Pitfalls

- Market orientation changes agricultural “safety net”
- Production and planting decisions more difficult with increased price uncertainty
- Marketing more difficult with increased price variability
- Tools for marketing and risk management will “work” differently; some tools will increase financial risk
- Land prices and asset values will also be volatile affecting longer run financial risk

Opportunities

- Increased flexibility and opportunity to benefit from market signals and prices
- Strong farm income from crops over the short run
- Large rewards for efficient production, marketing, and risk management

To conclude, the FAIR Act of 1996 is a watershed change in U.S. agricultural policy with a dramatic shift away from government intervention in agricultural markets. The greater market orientation with FAIR does offer production agriculture more flexibility to respond to market signals, but the reduced intervention also implies reduced government support during economic downturns. For producers and business entities that adapt quickly to this increased market orientation and employ efficient, integrated management practices, new opportunities for increasing profitability will exist over the next seven years.

For entities that are slow to adjust to this new environment, the next few years will, no doubt, exhibit financial difficulty and possible default.

In 2002, at the expiration of the seven year period authorized for production flexibility contracts, it is uncertain what direction U.S. agricultural policy will take. Because the permanent law provisions for price support and the Farmer Owned Reserve were only suspended, and not eliminated, in seven years Congress will have to address commodity programs again. What determines that policy will, in part, depend on recommendations from the Commission on 21st Century Agriculture. However, in the end, the primary motivating influences for policy will come from the economic and political situation at that time.